The Failure and Potential Redemption of Federal Merger Policy

Introduction

The Open Markets Institute[*] (OMI) welcomes the opportunity to offer its perspective for the FTC's Hearings on Competition and Consumer Protection in the 21st Century (Project Number P181201). OMI submits this comment to explain the failure of FTC and DOJ anti-merger enforcement and offer recommendations on how the federal antitrust agencies can restore effective merger policy.

The Federal Trade Commission's (and Department of Justice's) anti-merger enforcement requires a radical overhaul. Empirical study has raised serious doubts about their merger practice and philosophy. Since the early 1980s, the FTC and the DOJ have adopted the belief that corporate mergers generally yield consumer benefits, such as economies of scale, and that only horizontal mergers in very highly concentrated markets are likely to threaten competition. Accordingly, the federal antitrust agencies challenge only a tiny fraction of all mergers.

This lenient approach to merger enforcement has real consequences. A growing body of research has found that merger law is underenforced and that the DOJ and the FTC permit many anticompetitive mergers to be completed. Research has found that corporate consolidation, especially horizontal consolidation, contributes to higher prices and mark-ups and generally do not yield the promised economies of scale and other efficiencies.

Notably, the economist John Kwoka, in a recent extensive study of completed horizontal mergers, found that federal merger policy has failed even when judged by the narrow price and output measures of the "consumer welfare" philosophy of enforcement.[1] The lenient enforcement of anti-merger law in recent times has also harmed citizens in numerous other ways, including lower wages, less liberty to change jobs, and rapidly growing concentration of wealth and power that endangers American democracy.

To strengthen merger enforcement, the FTC – along with the DOJ – must simplify the analytical framework they use to evaluate proposed mergers. The agencies' current approach, embodied in the 2010 Horizontal Merger Guidelines, follows a rule of reason approach. The Guidelines call for the agencies to define the relevant markets, compute market shares and concentration, assess competitive effects, and evaluate possible efficiency and entry defenses.[2]

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[*] The Open Markets Institute is a non-profit organization dedicated to promoting fair and competitive markets. It does not accept any funding or donations from for-profit corporations. Its mission is to safeguard our political economy from concentrations of private power that undermine competition and threaten liberty, democracy, and prosperity. The vigorous enforcement of the antitrust laws is essential to protecting the U.S. economy and democracy from monopoly and oligopoly. The Open Markets Institute regularly provides expertise on antitrust law and competition policy to Congress, journalists, and other members of the public

[1] JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY (2015).

[2] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010).

This approach gives law enforcers at the agencies immense leeway to analyze mergers in a highly arbitrary fashion, leading to great inconsistency from one economic sector to another and even from one case to another. It also requires the agencies to predict and compare often non-commensurable competitive effects, such as post-merger price increases, changes to quality, and effects on innovation. In place of this overly complex, highly speculative, and often entirely arbitrary mode of inquiry and enforcement, a rules-based approach based on market share and concentration would produce superior outcomes (even from a consumer welfare angle).

The FTC, along with the DOJ, must develop new guidelines on horizontal and vertical mergers. The agencies should look to the 1968 Merger Guidelines as a template.[3] Accordingly, they should abandon the current rule of reason-like framework and establish market share and market concentration thresholds for horizontal and vertical mergers. Mergers that exceed these thresholds should be presumptively or per se illegal. In setting the precise thresholds, the agencies should look to both the Clayton Act's purpose and the recent empirical research. The Clayton Act is an incipiency statute that prohibits mergers that *threaten* competitive harm. Furthermore, recent empirical research has found that simple merger rules are highly accurate (as defined by the measures of the consumer welfare philosophy). Given the relevant statute and the latest economic research, the FTC and the DOJ should publish new merger guidelines that establish presumptions of illegality for mergers based on market share and concentration thresholds.

I. Growing Body of Research Undermines Agencies' Current Merger Philosophy and Enforcement Practices

A significant body of research has raised serious doubts about the federal antitrust agencies' current approach to mergers. At present, the agencies' philosophy on anti-merger enforcement is that mergers generally do not threaten competition and that mergers often generate economies of scale and other efficiencies. In practice, this means that the agencies generally only seek to block or remedy horizontal mergers in highly concentrated markets. But recent economic research has challenged these assumptions and found that horizontal mergers frequently lead to price increases and generally fail to produce efficiencies. These findings call for a fundamental overhaul and strengthening of federal anti-merger policy.

The work of economist John Kwoka has been particularly powerful in demonstrating that horizontal merger enforcement in recent years has been too permissive, even by the narrow criteria of the "consumer welfare" philosophy. Reviewing a large body of studies on completed mergers, Kwoka shows that the FTC and the DOJ frequently permitted horizontal mergers that lead to price increases and other adverse impacts on consumers. In his sample of studied mergers, Kwoka finds that most transactions led to a price increase, with a mean price increase of 4.31% across all mergers.[4] One studied merger led to a price increase of a 52.4%.[5]

[3] U.S. DEP'T OF JUSTICE, 1968 MERGER GUIDELINES.
[4] KWOKA, *supra* note 1, at 94.
[5] *Id.*

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Other research examines a larger data set of mergers and offers even more sweeping conclusions than Kwoka's work. Concentration has a strong positive correlation with price.[6] In recent decades, industrial concentration has increased across the U.S. economy and has contributed to higher firm profits.[7] A study by Bruce Blonigen and Justin Pierce examined the price markup and productivity effects of mergers in the manufacturing sector.[8] They find that mergers, in particular the horizontal mergers, produce higher price-cost markups and generally do not improve plant- or firm-level productivity.[9] This lack of merger-related productivity improvements is in line with a comprehensive 1987 study that also found that mergers in general failed to yield economic efficiencies and indeed, more often than not, resulted in a *loss* of efficiency.[10]

The failure of FTC merger policy has broad economic and political consequences. The lenient enforcement of anti-merger law harms citizens in ways besides higher prices for consumer goods and services. These harms include lower wages,[11] less liberty to change jobs,[12] and rapidly growing concentration of wealth and power that endangers American democracy.[13]

These findings undermine key assumptions of current merger policy. The FTC and the DOJ today presume that, outside of highly concentrated markets, mergers are generally benign and indeed often yield efficiencies.[14] The latest research discredits and, at a minimum, challenges the agencies' optimistic assumptions about the realization of efficiencies through corporate consolidation. Merger policy today is systematically too weak: the agencies permit many mergers that harm citizens, both in their capacity as buyers and in their capacity as sellers.

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[6] Orley Ashenfelter, Daniel Hosken & Matthew Weinberg, *Did Robert Bork Understate the Competitive Impact of Mergers? Evidence from Consummated Mergers*, 57 J.L. & ECON. S67 (2014); Leonard W. Weiss, *Conclusions, in* CONCENTRATION AND PRICE (Leonard W. Weiss ed., 1989).

[7] Gustavo Grullon, Yelena Larkin & Roni Michaely, *Are U.S. Industries Becoming More Concentrated?* 36-38 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2612047.

[8] Bruce A. Blonigen & Justin R. Pierce, *Evidence for the Effects of Mergers on Market Power and Efficiency* (NBER Working Paper No. 22750, October 2016).

[9] *Id.* at 3-5.

[10] F.M. SCHERER & DAVID J. RAVENSCRAFT, MERGERS, SELL-OFFS, AND ECONOMIC EFFICIENCY 202-03 (1987).

[11] Efraim Benmelech, Nittai Bergman & Hyunseob Kim, *Strong Employers and Weak Employees: How Does Employer Concentration Affect Wages?* 3 (2018); José Azar, Ioana Marinescu & Marshall I. Steinbaum, *Labor Market Concentration* 10 (2017), http://www.marinescu.eu/AzarMarinescuSteinbaum.pdf.

[12] José Azar, Ioana E. Marinescu, Marshall Steinbaum & Bledi Taska, *Concentration in U.S. Labor Markets: Evidence from Online Vacancy Data* 16-17 (2018), https://www.econstor.eu/bitstream/10419/177183/1/dp11379.pdf.

[13] Martin Gilens & Benjamin I. Page, *Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens*, 12 PERSP. ON POL. 564, 565 (2014); Arthur E. Wilmarth Jr., *Turning a Blind Eye: Why Washington Keeps Giving in to Wall Street*, 81 U. CIN. L. REV. 1283, 1328, 1446 (2013)

[14] *See* HORIZONTAL MERGER GUIDELINES § 10 ("[A] primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products.")

II. The Agencies Must Strengthen Anti-Merger Policy through Clear Rules

This substantial body of empirical research calls for a qualitative strengthening of anti-merger policy. Even if one believes that consumer welfare should remain the only goal of antitrust and anti-merger law, the research demonstrates that current merger policy is in need of radical overhaul. Going forward, the FTC, together with the DOJ, should seek to strengthen merger policy.

OMI believes the only way to effectively strengthen merger policy is through the adoption of clear rules. A rules-based approach is superior to the current standards-based approach for at least three reasons: rules are consistent with the incipiency standard in the Clayton Act, rules are easier to administer than standards, and rules are highly accurate.

The Clayton Act is an incipiency statute intended to stop anticompetitive mergers before they inflict harm on the public. The statute is focused on probabilistic, not certain, harms. Congress enacted and subsequently strengthened the anti-merger provision of the Clayton Act "to arrest the growth of market power before it reaches the point at which the Sherman Act would come into play."[15] Given the record of the Sherman Act, the drafters of the Clayton Act and its 1950 amendments (Celler-Kefauver Antimerger Act) believed that monopolies and oligopolies had to be prevented before they emerge and become entrenched.[16] Accordingly, the Clayton Act addresses "[m]ergers with a probable anticompetitive effect," not just "clear-cut menaces to competition."[17] Like the Clayton Act, the FTC Act also features a similar incipiency standard and prohibits conduct that threatens to reduce competition.[18]

The incipiency standard and prophylactic orientation of the Clayton Act (and the FTC Act) favor a rules-based approach to merger policy. In enacting the Clayton Act, Congress made clear that it wants law enforcers to stem economic concentration at an early stage. The standards-based approach the FTC and DOJ adopted a generation ago frustrates this goal. By stressing competitive effects such as near-term increases in price or deterioration in product quality, the FTC and the DOJ handicap their ability to prevent many anticompetitive mergers. Further, the quest for statistical certainty contravenes the legislative intent of the Clayton Act. As the Supreme Court stated in *United States v. Philadelphia National Bank*, the Clayton Act's intended prevention of competitive harms may be subverted by "permitting a too-broad economic investigation."[19] In contrast, a rules-based approach with low market share and concentration thresholds is consistent with, and advances, the incipiency standard of the Clayton Act.

More generally, it can be difficult or even impossible to effectively administer standards. An effects-based approach to merger policy requires predictions of quantitative and qualitative

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[15] Phil C. Neal, *The Clayton Act and the Transamerica Case*, 5 STAN. L. REV. 179, 203 (1953).
[16] Sen. Rep. No. 698, 63d Cong., 2d Sess. 1 (1914); S. Rep. No. 1775, 81st Cong., 2d Sess. 4 (1950).
[17] Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962).
[18] FTC v. Motion Picture Advertising Service Co., 344 U.S. 392, 394-95 (1953).
[19] 374 U.S. 321, 362 (1963).

harms and benefits from a proposed merger. The administrative challenges are clear: how accurately can any agency predict the price, quality, and innovation effects from a merger and furthermore balance them against each other?[20] The empirical record indicates that the agencies have been systematically underestimating the adverse effects of horizontal merger. Given the fundamental analytical challenges, it is far from clear that this process can ever be made to work effectively.[21]

Perhaps even more to the point, it is unclear that any such system can ever achieve the economic and political goals the American people, acting though Congress, built into antitrust law, including the Clayton Act.[22] More than 40 years ago, the Supreme Court acknowledged the difficulty—arguably impossibility—of performing these analytical tasks on a case-by-case basis. In *United States v. Topco Associates, Inc.*, the Court stated that "[t]o analyze, interpret, and evaluate the myriad of competing interests and the endless data that would surely be brought to bear on such decisions, and to make the delicate judgment on the relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required."[23] And earlier, the Court, rejected an efficiencies defense in merger cases because it would not only defy the intent of Congress but also require an "ultimate reckoning of social or economic debits and credits" and "[a] value choice . . . beyond the ordinary limits of judicial competence."[24]

By contrast, systems based on simple rules, such as the structural presumption against large horizontal mergers in concentrated markets, has an excellent track record, not only in protecting the broad economic and political interests of citizens but also their interests as consumers. John Kwoka has shown that that presumptions based on market concentration are highly accurate in screening anticompetitive mergers from benign mergers. An assortment of concentration measures correctly identify more than 80% of mergers that led to a subsequent price increase.[25] And looking beyond market concentration numbers, simple firm counts are also highly accurate in screening anticompetitive mergers.[26] Kwoka finds that mergers are always anticompetitive when five or fewer competitors remain after the merger.[27] When a merger reduced the number of firms from seven to six, the firm count screen was still quite accurate: 80% of mergers in this category resulted in a price increase.[28]

[20] Rebecca Haw Allensworth, *The Commensurability Myth in Antitrust*, 69 VAND. L. REV. 1, 16-24 (2016).
[21] K. SABEEL RAHMAN, DEMOCRACY AGAINST DOMINATION 99 (2016).
[22] For a review of the economic and political goals of Congress in enacting the antitrust laws, see generally Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 126–41 (1982).
[23] 405 U.S. 596, 611-12 (1972).
[24] *Philadelphia National Bank*, 374 U.S. at 371.
[25] John Kwoka, *The Structural Presumption and the Safe Harbor in Merger Review: False Positives or Unwarranted Concerns?*, 81 ANTITRUST L.J. 837, 859-64 (2017).
[26] *Id.* at 863.
[27] *Id.*
[28] *Id.* Notably, the evidence for simple rules *in favor* of corporate consolidation is very weak. In markets with low concentrations (as defined by the Horizontal Merger Guidelines), the agencies presume—almost conclusively—that horizontal mergers are competitively benign. This safe harbor, however, has permitted mergers that had

Conclusion

The empirical evidence reveals that federal anti-merger policy has, from even a narrow consumer welfare perspective, failed. The current approach of tolerating most mergers and simply assuming these mergers generate consumer efficiencies has been discredited. The failure of merger policy is even more severe when a broader set of antitrust objectives, such as protecting workers from employer market power and limiting the political power of corporations and big investors, is considered. Even if the agencies remain committed to interpreting antitrust and anti-merger law as a "consumer welfare prescription,"[29] they must fundamentally rethink their enforcement and philosophy on mergers. They need to abandon their philosophical belief that mergers are generally competitively benign and so should be subject to permissive treatment under the antitrust laws. Furthermore, the current approach to merger enforcement is opaque, undermining public accountability and promoting subjective enforcement decision-making.[30] One notable antitrust lawyer has observed that "[t]here are few government functions outside the CIA that are so secretive as the merger review process."[31]

An earlier iteration of the merger guidelines—the Department of Justice's 1968 Merger Guidelines—offers a superior alternative to the current approach.[32] These Guidelines apply a rules-based approach and set out strong presumptions of illegality based on market share and market concentration thresholds. This model is consistent with the Clayton Act's emphasis on the prevention of possible competitive harms from mergers. In addition to promoting competitive market structures, the Department of Justice recognized a rules-based system promotes both administrative efficiency and the rule of law. The DOJ stated that "an enforcement policy emphasizing a limited number of structural factors . . . facilitates both enforcement decision-making and business planning which involves anticipation of the Department's enforcement intent."[33] The Supreme Court has similarly endorsed clear merger rules because they simplify enforcement and aid business planning.[34] Notably, the 1968 Merger Guidelines rejected an efficiencies defense, noting that companies can achieve possible efficiencies through internal

anticompetitive consumer effects. Of the nine mergers that qualified for the safe harbor in Kwoka's sample, seven—or nearly 80% of the mergers—led to price increases. *Id.* at 864-65.

[29] Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979) (quoting ROBERT BORK, THE ANTITRUST PARADOX 66 (1978))

[30] Jesse Eisinger & Justin Elliott, *These Professors Make More Than a Thousand Bucks an Hour Peddling Mega-Mergers*, PROPUBLICA, Nov. 16, 2016, https://www.propublica.org/article/these-professors-make-more-than-thousand-bucks-hour-peddling-mega-mergers. For a comprehensive critique of the rule of reason (analytically similar to the current Horizontal Merger Guidelines) in antitrust, see generally Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375 (2009).

[31] Eisinger & Elliott, *supra* 30.

[32] U.S. DEP'T OF JUSTICE, 1968 MERGER GUIDELINES.

[33] *Id.* at § 2.

[34] *Philadelphia National Bank*, 374 U.S. at 362.

expansion (in lieu of mergers and acquisitions).[35] And the latest research shows that, even from a narrow consumer welfare perspective, rules are superior to the current standards-based approach.

The FTC, together with the DOJ, should look to the 1968 Merger Guidelines in promulgating new guidelines. The current approach to merger enforcement, based on dubious – and now discredited – assumptions, has permitted many horizontal mergers that led to higher consumer prices, promoted administrative inefficiency, and diminished transparency and the rule of law. To restore the effectiveness of the Clayton Act, the FTC, along with the DOJ, should publish new merger guidelines informed by the wisdom of the guidelines from 1968. Failure to do so would mean continued toleration of corporate consolidation that hurts consumers, and also workers, entrepreneurs, and democratic institutions.

[35] 1968 MERGER GUIDELINES at § 10, 16. The Supreme Court has also held that an efficiencies defense is inconsistent with the Clayton Act. *See Brown Shoe*, 370 U.S. at 344 ("Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization."); *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967) ("Possible economies cannot be used as a defense to illegality.").